4/7/82 R4105 - 5.36

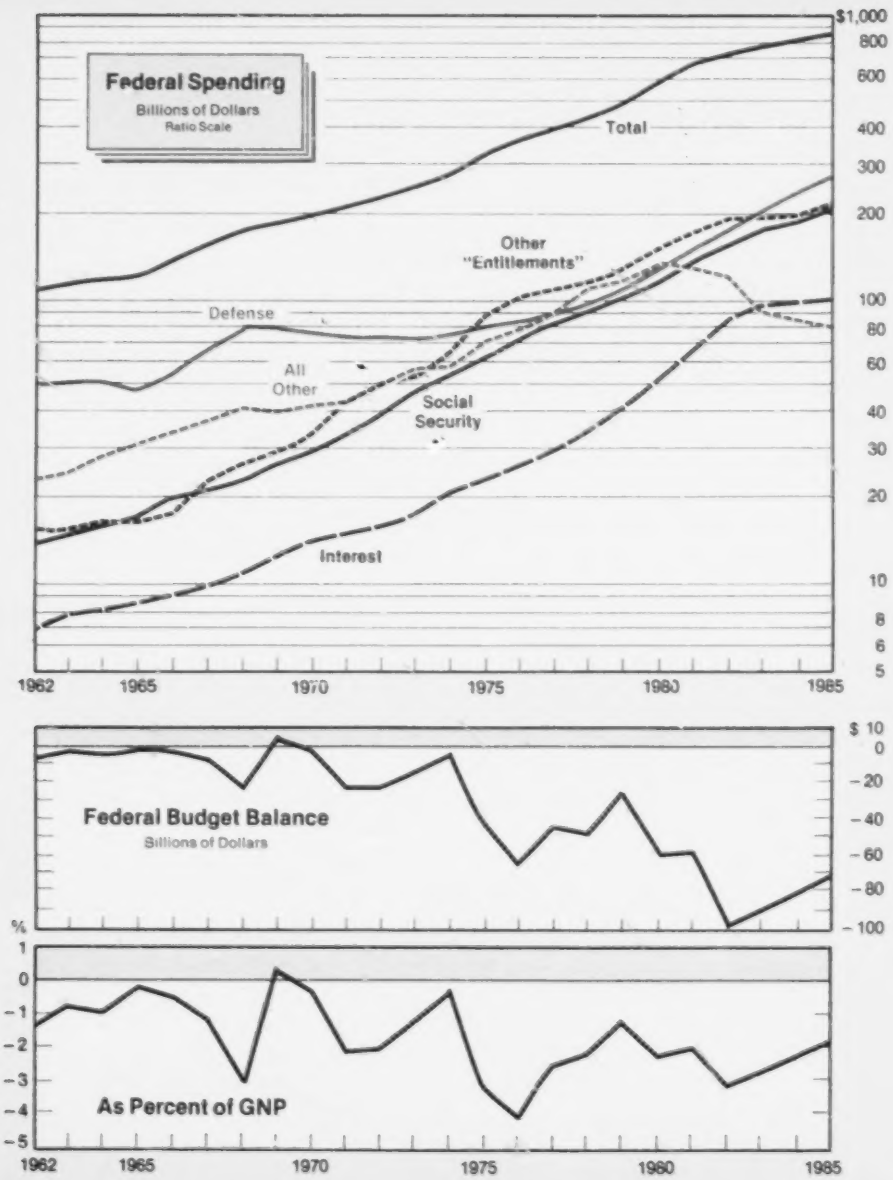
The Conference Board

Federal Spending

Economic Road Maps
Nos. 1922-1923

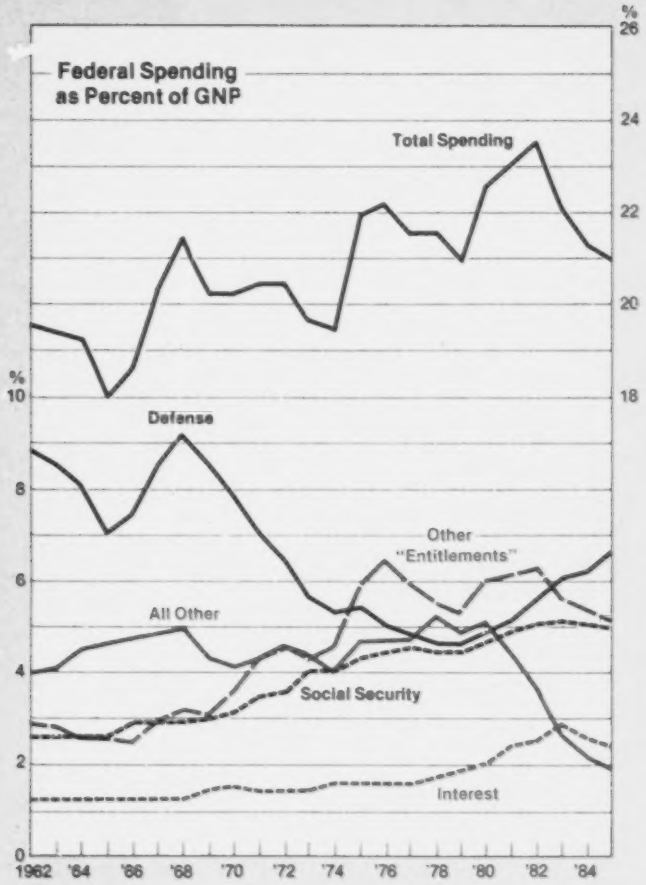
March, 1982

The President's budget message, sent to Congress in February, proposes total outlays of $758 billion in fiscal year 1983. Outlays in 1984 and 1985 are estimated at $806 billion and $868 billion, respectively. Actual outlays in fiscal 1981, which ended last September 30, were $657 billion; the current projection for fiscal 1982 is $725 billion. The President's proposals include a rapid rise in defense spending, a leveling of interest payments, continued growth in spending for social security and other so-called "entitlement" programs, and an outright decline in the aggregate of all other federal spending. This Road Map shows the proposed figures in the context of past trends, as an aid to understanding the budgetary debate that will be occurring this Spring.



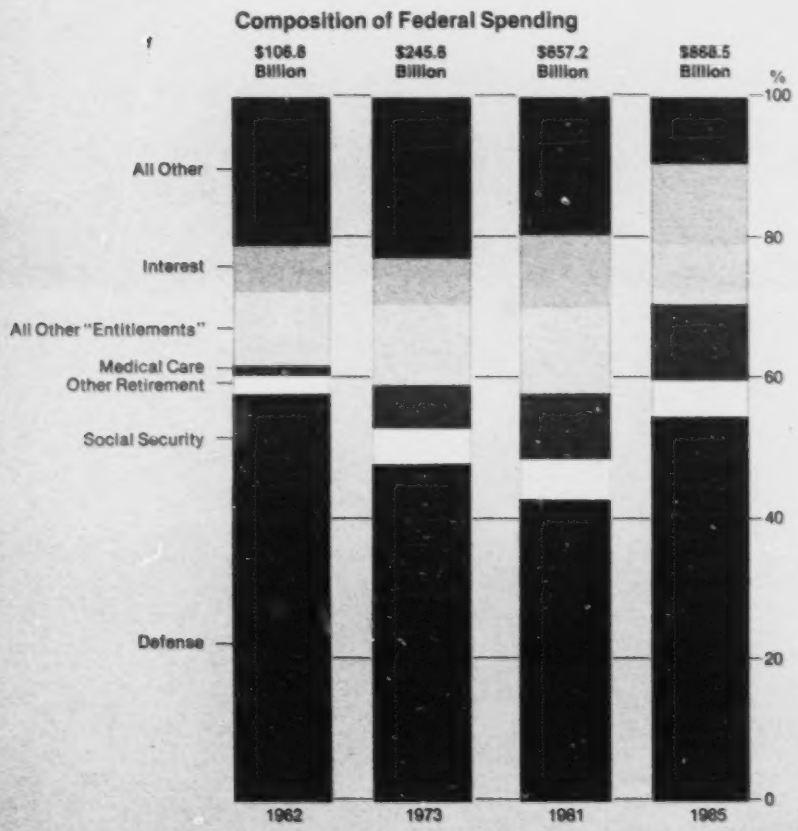
The budget proposes a deficit of $91.5 billion in 1983, to shrink to $71.9 billion by 1985. Because these are such big numbers, it helps to put them into perspective by relating them to GNP, which is the current market value of the nation's total production of goods and services. The post-World War II peak in the deficit/GNP ratio was 4.0% in fiscal 1976, in the wake of the 1974-1975 recession. The ratio will be about 3.2% in fiscal 1982 and is projected to drop to 1.9% by 1985. However, there has been criticism that the budget assumes too much GNP growth and too little inflation. If the assumptions are wrong, the deficit/GNP ratio will be higher. Many people believe that deficits are automatically inflationary; but, although deficits have indeed often brought about inflationary increases in total purchasing power, they need not do so. However, even if deficits are financed in a noninflationary way, they absorb saved resources that would otherwise probably go into expansion of the capital stock.

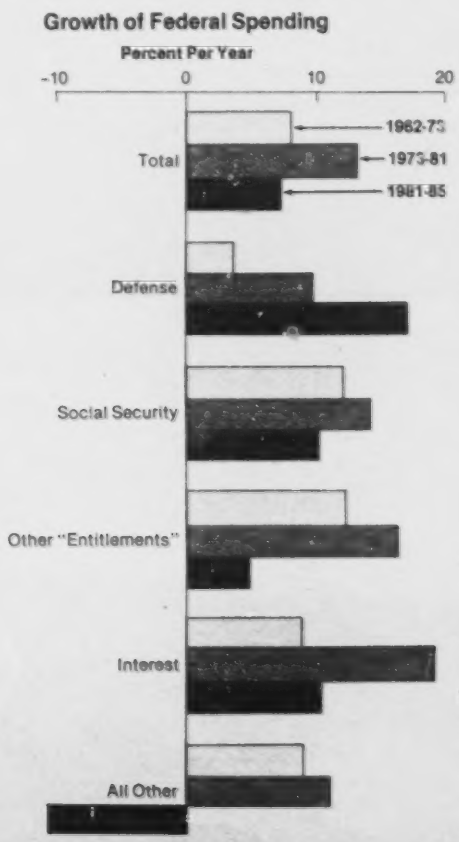
Until the mid-1970's, defense was the largest of the major categories into which federal spending is divided on the chart at the left and on other charts on page 2. Since then, however, defense spending growth has

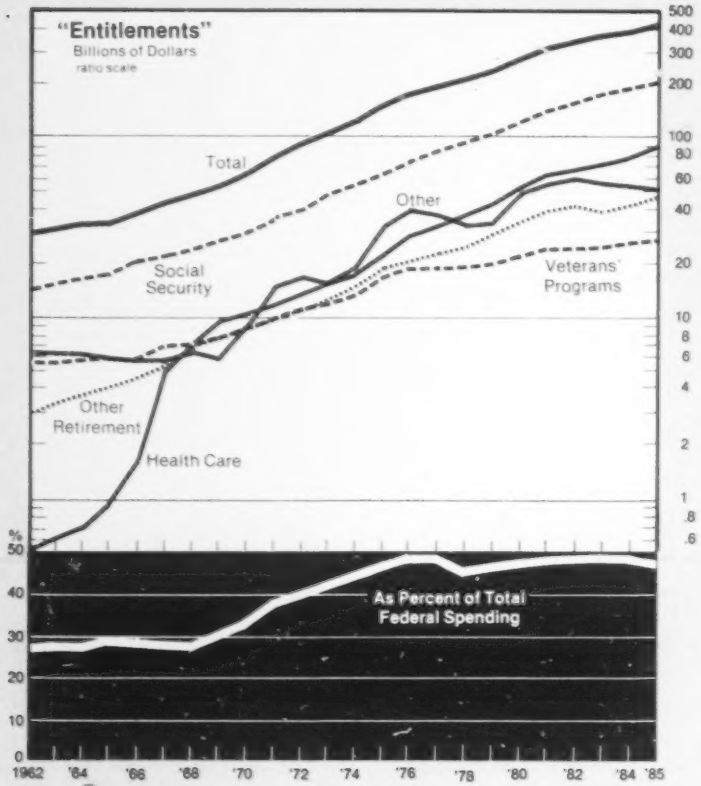


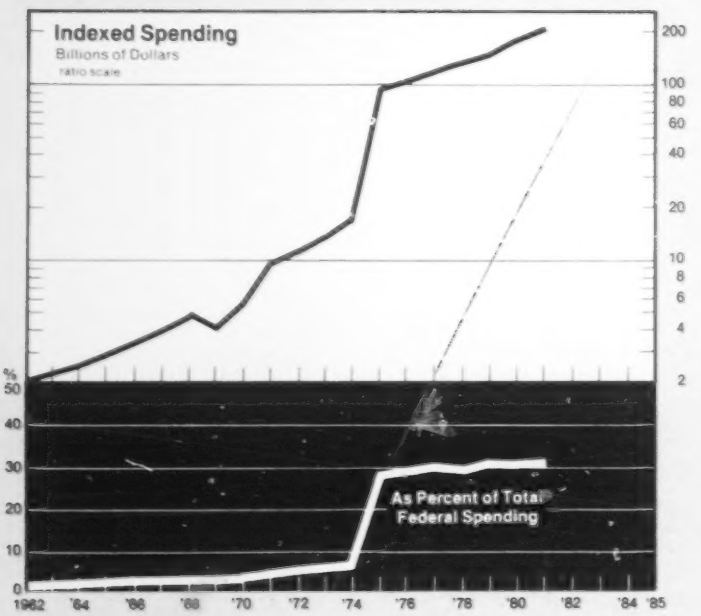
been slow while outlays on social programs have surged. The President's budget proposes to reverse this trend. As the chart at the lower right shows, defense spending growth is to accelerate to 17% per year in 1981-1985 while other spending categories either grow less rapidly than in the 1970's or decline outright. The chart at the top of page 4 breaks down the proposed defense increase into its major components. These proposals would bring the defense share of the budget to 31.5% in fiscal 1985, from 22.2% in 1981. To make room for this rise, the budget share of nondefense programs other than "entitlements" is to drop from 19.4% in 1981 to 9.2% in 1985 (chart at lower left).

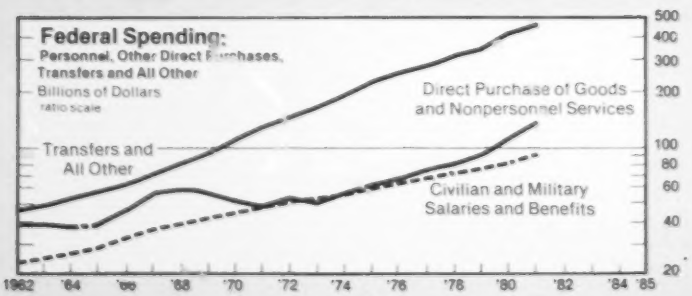
The ratio of total spending to GNP is projected at 23.5% in the current fiscal year, dropping then to 20.9% by fiscal 1985. This ratio moves up when the economy is weak, because spending is boosted by items such as unemployment compensation, while GNP is depressed. However, while the recent rise in the spending/GNP ratio is certainly in part cyclical, it also seems to reflect a more underlying trend. The defense/GNP ratio ran between 7% and 9½% from the end of the Korean War to the end of the 1970's, then declined to 4.6% in fiscal 1978 and 1979. The President's proposals would move it to 6.6% by 1985. These defense calculations exclude military retirement, which is part of defense in the offical budget. These costs (about ½% of GNP) are here included in spending for "entitlement" programs.








Indexed Spending
Billions of Dollars
ratio scale
%
As Percent of Total Federal Spending
1962 '64 '66 '68 '70 '72 '74 '76 '78 '80 '82 '84 '85


Federal Spending:
Personnel, Other Direct Purchases, Transfers and All Other
Billions of Dollars
ratio scale
Direct Purchase of Goods and Nonpersonnel Services
Transfers and All Other
Civilian and Military Salaries and Benefits
1962 '64 '66 '68 '70 '72 '74 '76 '78 '80 '82 '84 '85

Estimated Expenditure on "Entitlement" Programs Fiscal Year 1981

Billions of Dollars

Social security	138.0
Federal civilian retirement	17.5
Military retirement	13.7
Other retirement & disability[1]	7.0
Veterans' compensation, medical care, pensions, other benefits	23.0
Medicare & medicaid	60.4
Unemployment compensation	19.7
Food stamps & other nutrition aid	16.2
Other aid for the needy[2]	19.7
	315.2

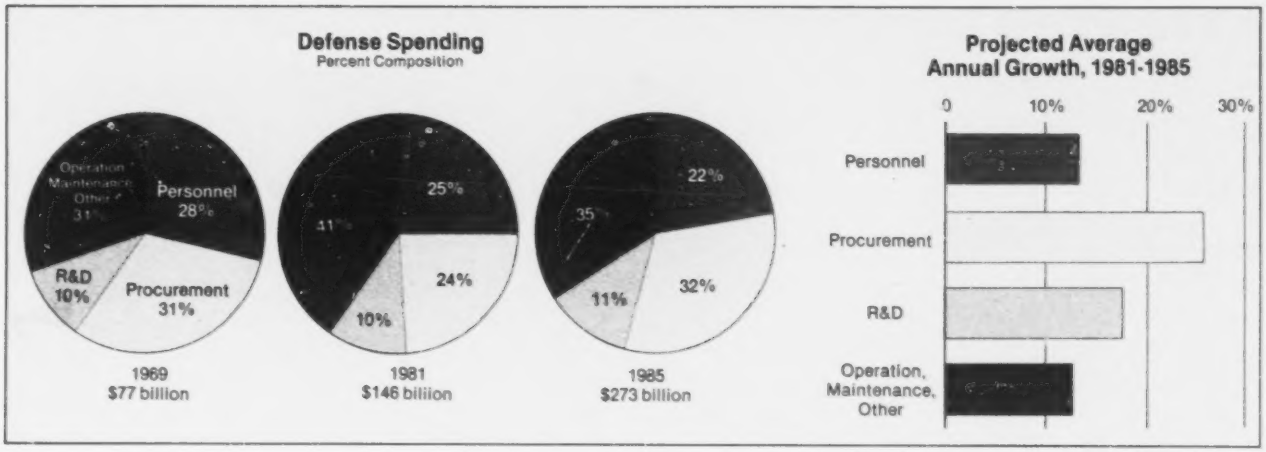
[1]Mainly railroad retirement and coal miners' disability.
[2]Mainly Aid to Families with Dependent Children, Supplemental Security Income and the Earned Income Credit on income taxes.

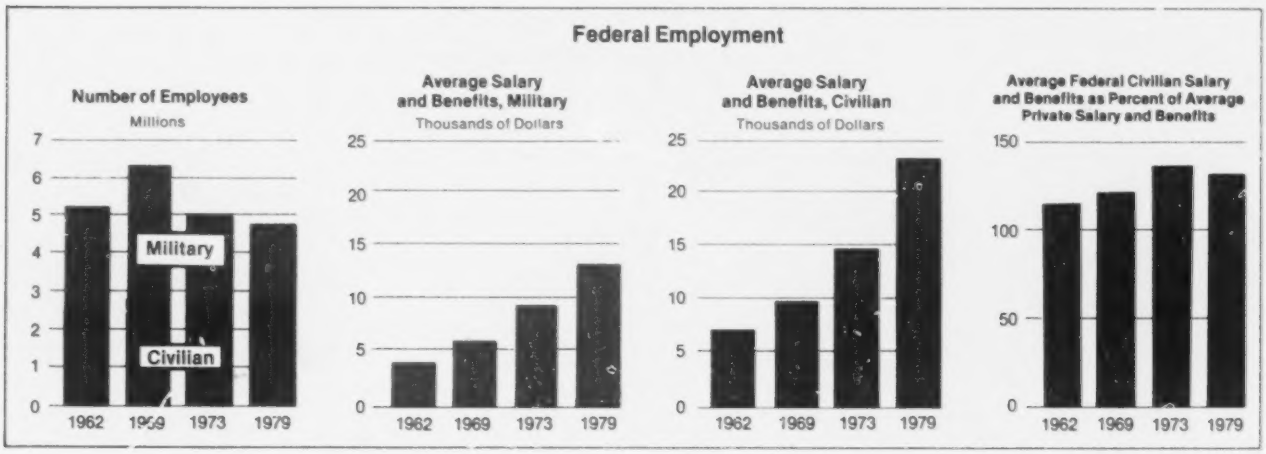
Expenditure on Major Programs that are Currently Indexed

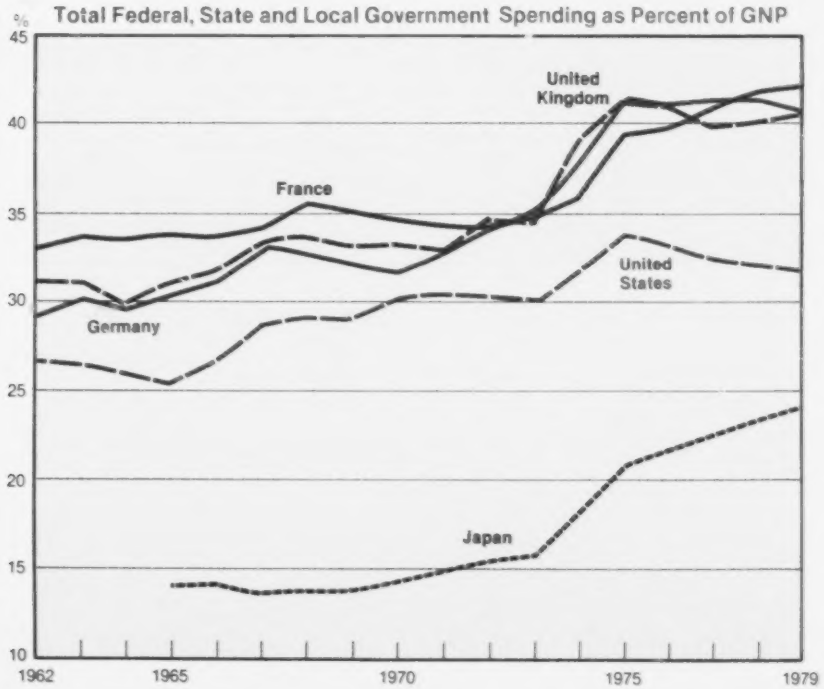
Billions of Dollars

	1969	1973	1981
Federal civilian retirement	1.8	4.5	17.5
Military retirement	2.4	4.4	13.7
Coal miners' disability	—	1.0	1.1
Food stamps & other nutrition aid	0.6	3.6	16.2
Social security	26.8	48.3	138.0
Railroad retirement	1.5	2.4	5.3
Supplemental security income	—	—	7.2
Veterans' pensions	2.1	2.6	3.8
Indexed total	4.2	13.5	202.8

The term "entitlements" is common in discussions of public spending, but there is no rigorous definition of just which Federal programs should be so characterized. The idea is that benefits are available automatically to persons who meet the criteria set in the relevant legislation. The table above lists 1981 outlays on programs that appear to provide "entitlement" benefits, and the chart carries the data back over the years. Problems of data availability forced the inclusion of some outlays, mainly for nutrition aid and some veterans' benefits, that are not really "entitlements", but these inclusions do not warp the broad picture. "Entitlements were 48% of federal







outlays in 1981. Some analysts would put federal interest payments in the "entitlement" category; on that basis, the 1981 budget share of "entitlements" was 58%, compared with 35% in the late 1960's. One reason for the surge in "entitlements" has been the development of indexation that automatically raises benefits according to a formula related to inflation. At the end of the 1960's, indexation affected only federal civilian and military retirement benefits, which were less than 3% of the budget. Social security was indexed in 1975, and by fiscal 1981, total indexed spending was $203 billion or 31% of the budget.

Lora S. Collins

Source: Office of Management and Budget, Bureau of Economic Analysis; OECD; The Conference Board.

ECONOMIC ROAD MAPS

Eva Culen, Editor Chuck N. Tow, Lead Chartist

Prepared in The Business Conditions Analysis Department—Lora S. Collins, Director
Prices for Quantities of this chart will be supplied on request to Information Service.

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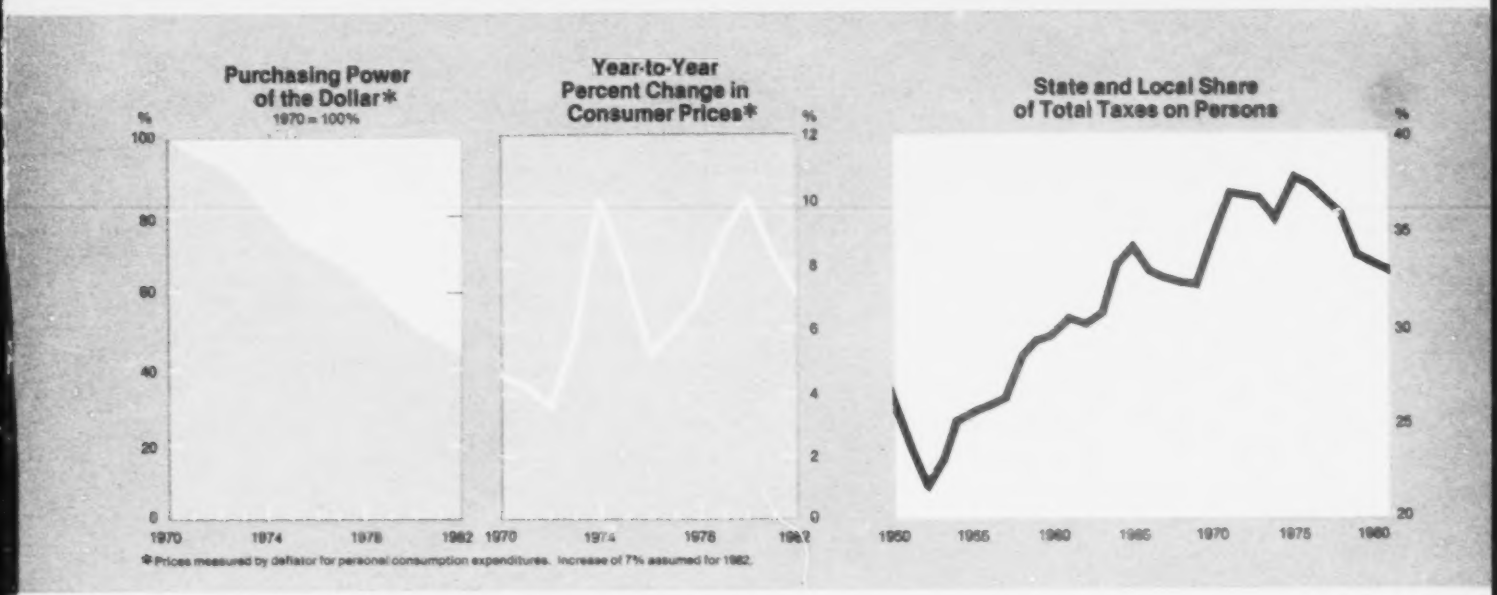
The Conference Board

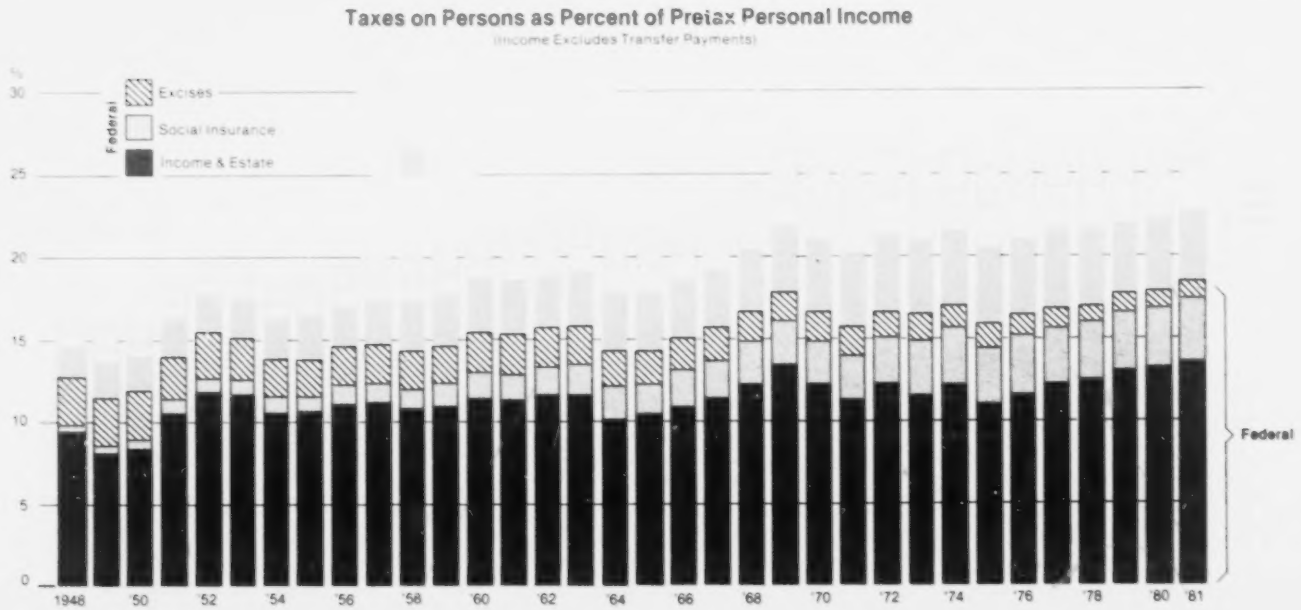
The Two-Way Squeeze, 1982

Economic Road Maps
Nos. 1924-1925

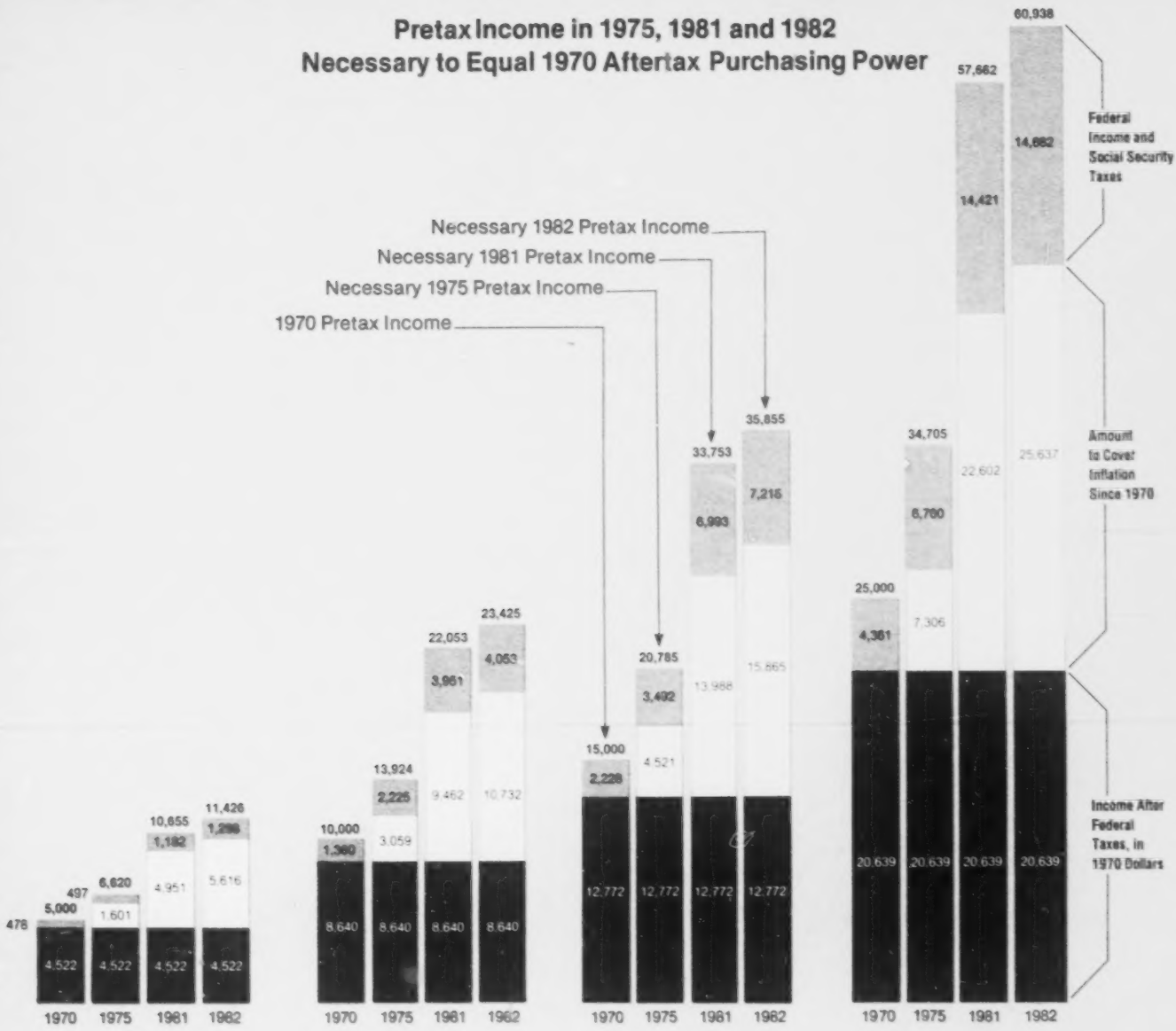
April, 1982

The inflation rate will almost certainly be lower in 1982 than in 1981. For the calculations presented here, the 1982 rise in the consumer price level is projected at 7%, compared with 8.3% in 1981 and 10.2% in 1980. However, even with the expected slowdown, a dollar in 1982 will have only 45% of the purchasing power that a dollar had in 1970. If a family had a $10,000 income in 1970—about the average then—it needs $23,425 this year to have the same after-tax real purchasing power it had then (page 2). The share of this hypothetical family's income taken by federal income taxes has risen from 9.9% in 1970 to 12.0% this year, while Social Security taxes have gone from 3.7% to 6.7% (page 3). These calculations relate only to federal taxes, because state-local taxes vary so greatly among jurisdictions.





Pretax Income in 1975, 1981 and 1982 Necessary to Equal 1970 Aftertax Purchasing Power

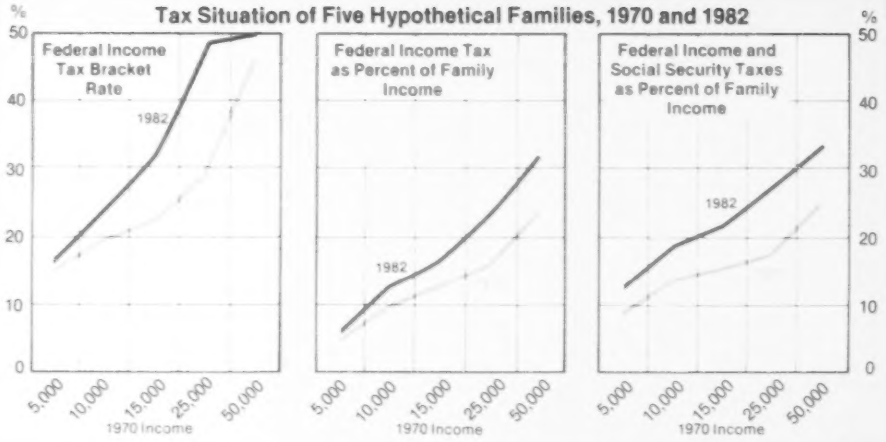


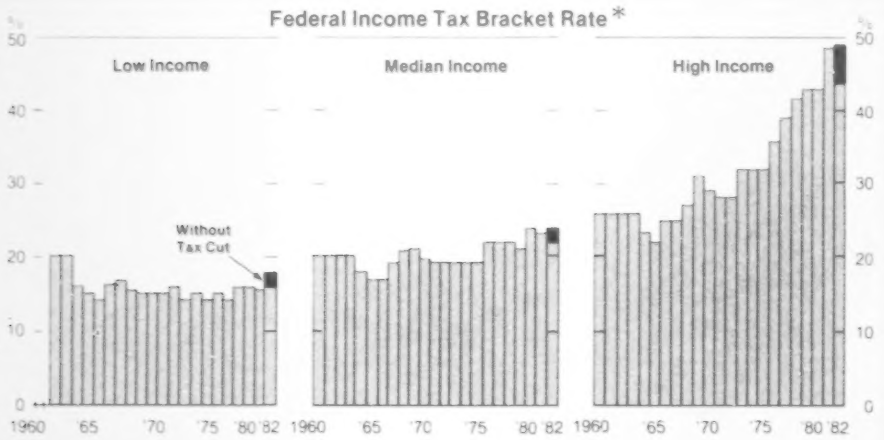
1970 PRETAX INCOME	$ 5,000	$10,000	$15,000	$25,000	$ 50,000
Less: Federal income tax	238	986	1,854	3,987	11,982
Less: Social security tax	240	374	374	374	374
Equals: Income after federal taxes	4,522	8,640	12,772	20,639	37,644
1975 NECESSARY PRETAX INCOME	6,620	13,924	20,785	34,705	70,592
Less: Federal income tax	110	1,411	2,667	5,935	18,797
Less: Social security tax	387	814	825	825	825
Less: Amount to cover inflation since 1970	1,601	3,059	4,521	7,306	13,326
Equals: Income after federal taxes, in 1970 dollars	4,522	8,640	12,772	20,639	37,644
1981 NECESSARY PRETAX INCOME	10,655	22,053	33,753	57,662	116,627
Less: Federal income tax	473	2,484	5,018	12,446	35,783
Less: Social security tax	709	1,467	1,975	1,975	1,975
Less: Amount to cover inflation since 1970	4,951	9,462	13,988	22,602	41,225
Equals: Income after federal taxes, in 1970 dollars	4,522	8,640	12,772	20,639	37,644
1982 NECESSARY PRETAX INCOME	11,426	23,425	35,855	60,938	122,873
Less: Federal income tax	522	2,484	5,047	12,491	36,298
Less: Social security tax	766	1,569	2,171	2,171	2,171
Less: Amount to cover inflation since 1970	5,616	10,732	15,865	25,637	46,760
Equals: Income after federal taxes, in 1970 dollars	4,522	8,640	12,772	20,639	37,644

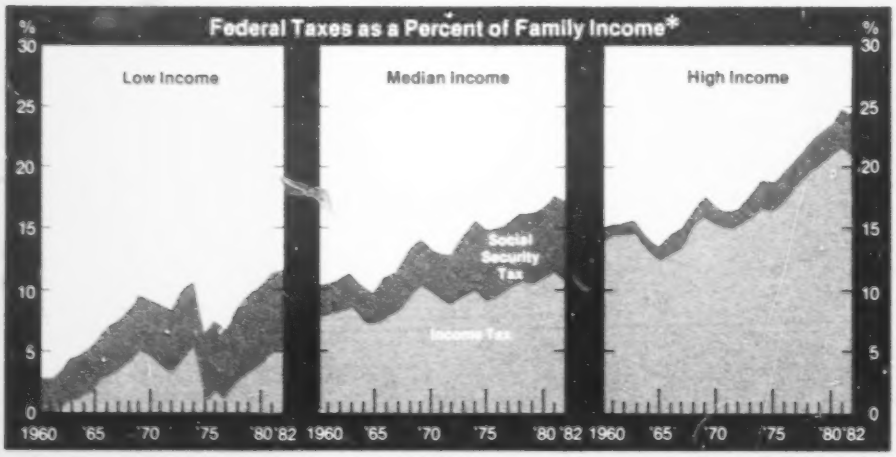
Federal income and social security taxes are computed for a married couple, only one of whom works, with two children. No allowance is made for any other taxes. Calculations use the tax laws in effect each year. Deductible items are assumed to equal 17% of pretax income in 1970, 20% in other years. For calculating maximum tax and earned income credit, all income is assumed to be earned, personal service income. Inflation is calculated from the deflator for personal consumption spending, with a 7% rise assumed from 1981 to 1982.

The chart on page 2 shows income before and after federal taxes for hypothetical families at selected income levels. The 1970 incomes of $5,000, $10,000, $15,000, and $25,000 represent approximately the 20th, 50th, 80th, and 95th percentile points in the income distribution that year. The family that had $10,000 then needs $23,425 in 1982 to have the same real after-tax income, a rise of 134%; the necessary 1970-1982 increases for the other families range from 128% for the one with a $5,000 income in 1970 to 146% for the one with $50,000 then. (The assumptions are outlined in the note on page 2). As the first panel of the chart immediately to the right shows, "tax bracket creep" has affected the hypothetical families at all five income levels,

Effect of 1982 Tax Cut					
1970 Pretax Income	$ 5,000	$10,000	$15,000	$25,000	$ 50,000
Necessary 1982 Pretax Income	11,426	23,425	35,855	60,938	122,873
Necessary 1982 Pretax Income, Assuming No Tax Cut	11,530	23,823	36,625	63,209	126,588







*Family income each year at the 20th, 50th, and 95th percentiles of the family income distribution. Income levels estimated for 1981 and 1982. Calculations assume 4-person family with one earner, as stated in table on page 2.

but has been most severe for upper-middle incomes. For instance, the family with $25,000 in 1970 was in the 28% bracket then; in 1982, if it has the $60,938 that is necessary to match its 1970 after-tax purchasing power, it is in the 49% bracket.

The calculations presented on page 2 and at the top of this page refer to hypothetical families. Actual family incomes have increased, on average, somewhat faster than the "necessary" increases calculated for the hypothetical families. This was true at least through 1980, the latest year for which data are available; in that year, the median family income was $21,023. The charts at the left show the income tax bracket rate, and taxes as a percent of income, for families whose income each year is at the 20th percentile of the income distribution ("low income"), the 50th percentile (median), and the 95th ("high income"). The 1981 and 1982 incomes are estimates. The income tax burden on the low-income family dropped in 1975 with the introduction of the earned income credit (EIC) for low-earning workers. The income

Changes in Federal Personal Income Tax Structure

1964: Minimum standard deduction increased. Taxable income bracket ranges increased and bracket rates cut.

1968: General tax surcharge of 7½%.

1969: General tax surcharge of 10%.

1970: General tax surcharge of 2½%. Personal exemption raised from $600 to $625.

1971: Personal exemption raised from $625 to $675. Minimum and percentage standard deductions increased. Maximum tax bracket rate on "earned" income set at 60%.

1972: Personal exemption raised from $675 to $750. Minimum and percentage standard deductions increased. Maximum tax bracket rate on "earned" income cut to 50%.

1975: Minimum and percentage standard deductions increased. Earned Income Credit for low-earning workers introduced. General tax credit of $30 per exemption.

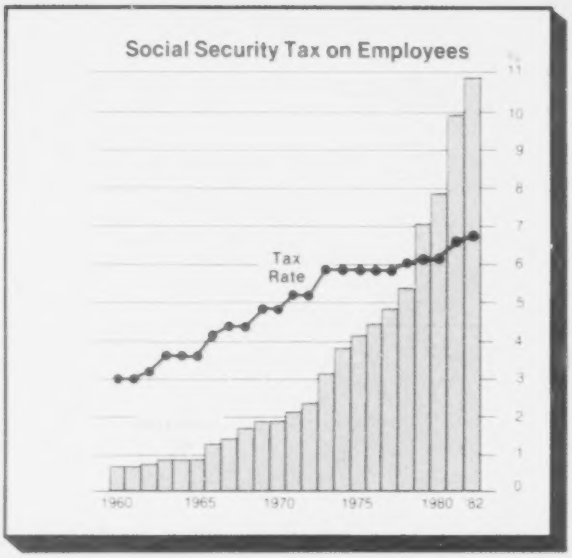
1976: Minimum and percentage standard deductions increased. General tax credit changed to $35 per exemption or 2% of taxable income up to $9,000.

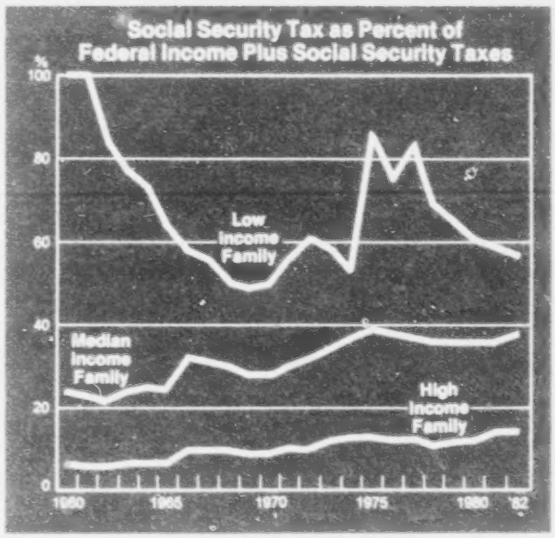
1977: Standard deduction increased and made a flat amount. Personal exemption raised from $750 to $1,000.

1979: Flat standard deduction increased. Taxable income bracket ranges increased and bracket rates cut. Earned Income Credit increased. General tax credit eliminated.

1981: Tax bracket rates cut.

1982: Tax bracket rates cut.





tax burden on this family has since risen because the EIC first shrank, then disappeared, as the money income of the family at the 20th percentile point rose. The EIC shrinks as family income moves up and disappears at an income of $10,000.

Social Security taxes have been escalating, as the chart at the upper right shows. For the low-income family, these taxes are dominant. In 1975, when the family's income tax burden was cut by introduction of the EIC, the Social Security tax accounted for over 80% of its total federal taxes (see chart above). Even after the recent rise in the income tax burden on this family, the Social Security tax is almost 60% of its 1982 federal taxes.

While the Social Security tax structure has trended upward, the income tax structure has been repeatedly cut. The table above summarizes the changes beginning in 1964. In 1963, the standard deduction was 10% of income to a maximum of $1,000, the personal exemption was $600, the first tax bracket for couples was 20% on taxable income below $4,000, and the third bracket was 26% on taxable income from $8,000 to $12,000. In 1982, the standard deduction is a flat $3,400 for a couple, the personal exemption is $1,000, the first bracket for couples is 12% on taxable income from $3,400 to $5,500, and taxable income has to reach the range $20,200 to $24,600 before the bracket rate reaches 25 percent.

Lora S. Collins

Sources: Bureau of the Census; Bureau of Economic Analysis; Internal Revenue Service; The Conference Board.

ECONOMIC ROAD MAPS

Eva Culen, Editor Chuck N. Tow, Lead Chartist

Prepared in The Business Conditions Analysis Department – Lora S. Collins, Director
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Corporate Profits 1981

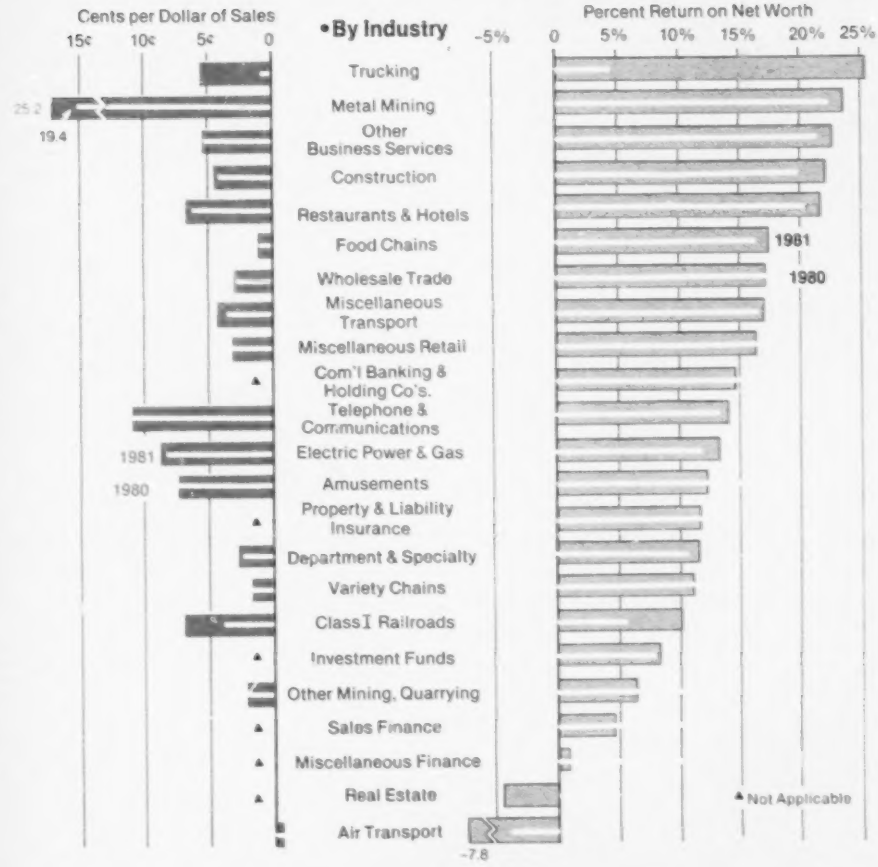
Economic Road Maps
No. 1926

May, 1982

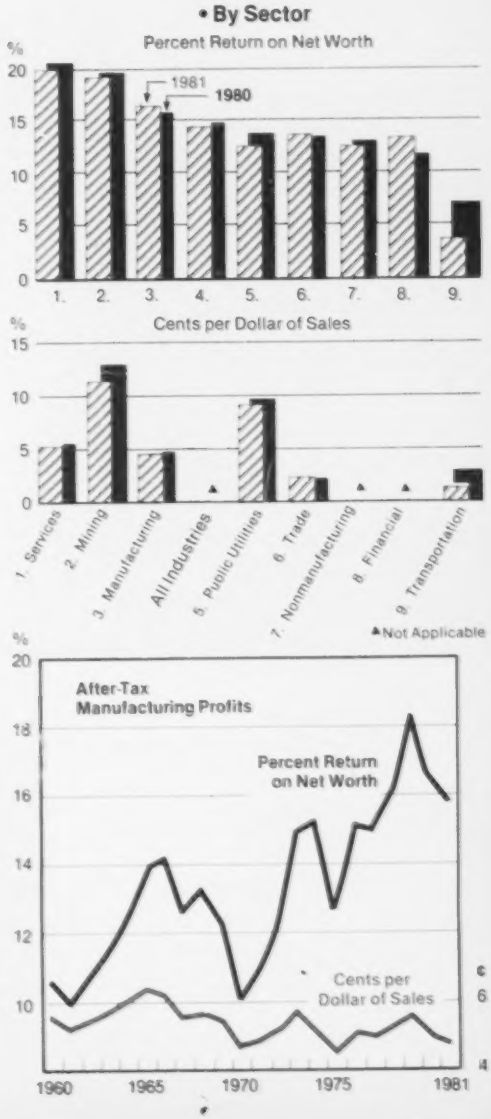
Total after-tax profits of major U.S. corporations advanced 9% from 1980 to 1981, according to the latest annual Citibank survey of profits. Nonmanufacturing corporations' profits were up 14% in 1981, while manufacturing profits increased 6 percent. In spite of a sluggish economy, high interest rates, and a strong dollar, the bulk of companies covered in the survey reported improved after-tax profits in 1981. Companies in the survey had profits of $129 billion on aggregate net worth of $889 billion. The 1981 return on manufacturers' net worth averaged 15.7% compared with 16.5% in 1980, and the average profit margin dipped to 4.8 cents per dollar of sales from 4.9 cents in 1980. Excluding the oil industry, the rate of return rose from 13.4% in 1980 to 14%, and the profit margin went from 4.4 cents to 4.6 cents.

Profits After Taxes - Nonmanufacturing

Leading Corporations



The Profit Picture



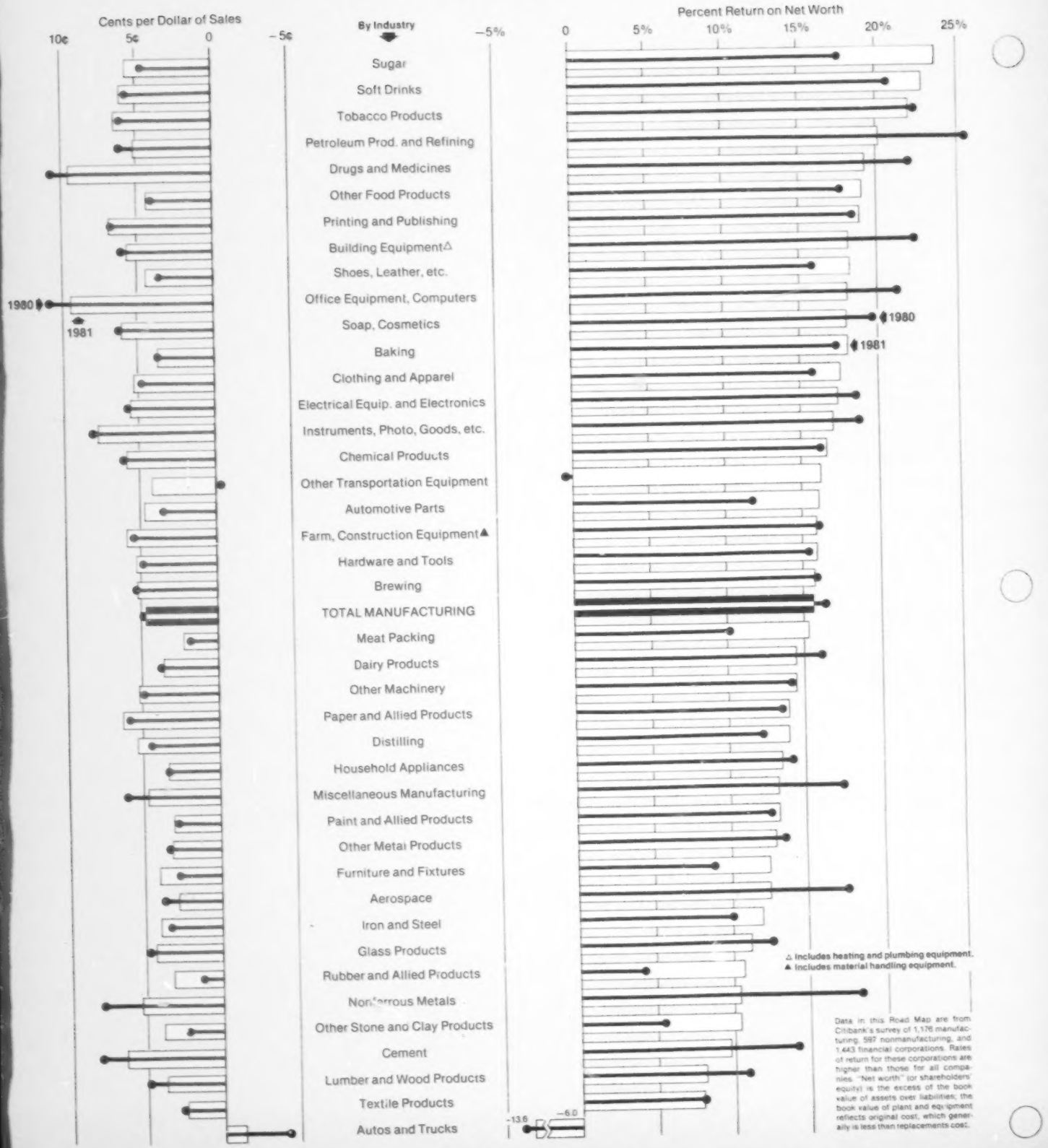
As in 1980, the automobile and petroleum industries again dominated the profit picture. The car and truck manufacturers lost $1.7 billion, a substantial improvement over the $4.6 billion deficit in 1980. The petroleum industry, which accounts for 35% of all manufacturing profits, had a 6% decline in after-tax profits despite a sales increase of 11 percent.

Sources: Citibank; The Conference Board.

Eva Culen

Profits After Taxes—Manufacturing

Leading Corporations



△ Includes heating and plumbing equipment.
▲ Includes material handling equipment.

Data in this Road Map are from Citibank's survey of 1,176 manufacturing, 597 nonmanufacturing, and 1,443 financial corporations. Rates of return for these corporations are higher than those for all companies. "Net worth" (or shareholders' equity) is the excess of the book value of assets over liabilities; the book value of plant and equipment reflects original cost, which generally is less than replacements cost.

ECONOMIC ROAD MAPS

Eva Culen, Editor Chuck N. Tow, Lead Chartist

Prepared in The Business Conditions Analysis Department—Lora S. Collins, Director
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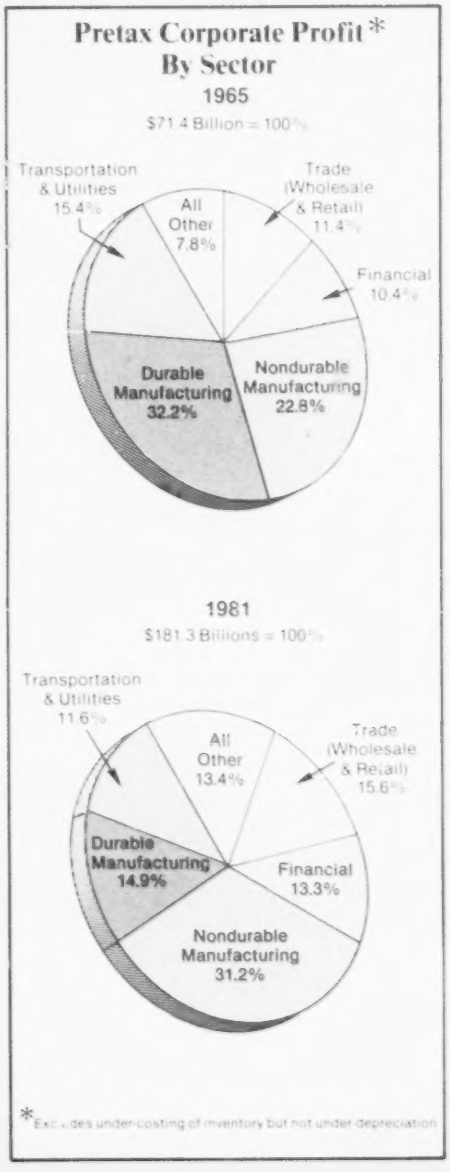
Profit Trends

Economic Road Maps

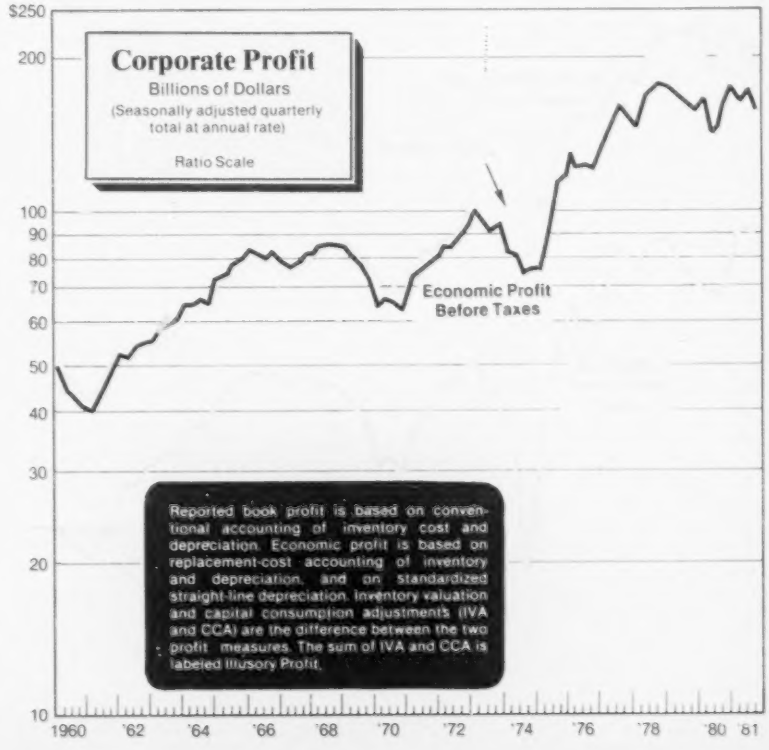
No. 1927 May, 1982

Corporations reported $209 billion in pretax profit on operations in the United States in 1981, down from $214 billion in 1980 and considerably lower than the $225 billion in 1979. However, the "illusory" portion of profit in the reported total was smaller in 1981 than in 1980, and the amount of true "economic" profit increased substantially—to $168 billion from $152 billion in 1980. Illusory profit results from the underdepreciation of fixed capital and undercosting of inventories, using conventional accounting methods. They are reported to shareholders as profit, and taxes are paid on them, but are not actually available for dividend payout or reinvestment in new plant and equipment. Economic profit, adjusted to eliminate the undercosting of production, recovered in 1981, but only back to levels reached in 1978 and 1979.

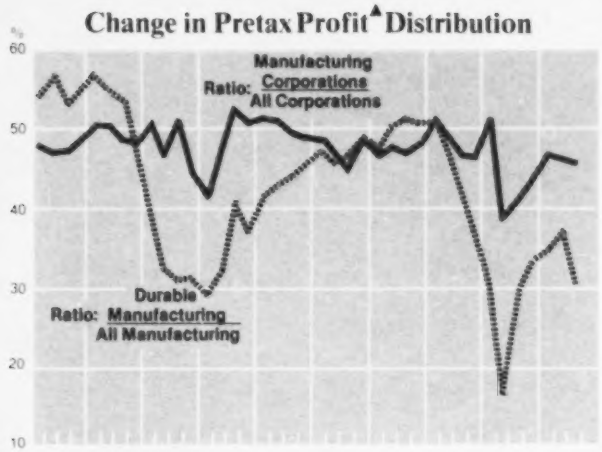


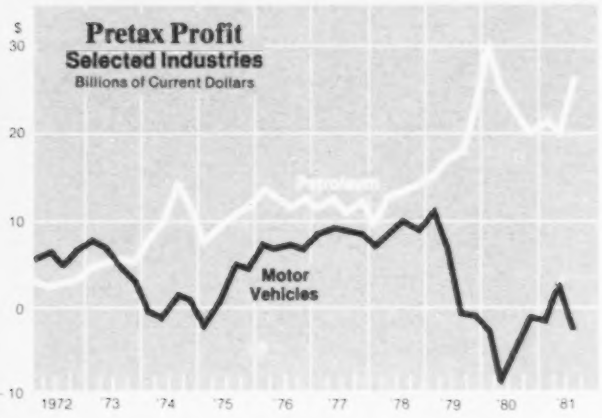
The understating of costs, which generates illusory profit, results from the way in which conventional accounting methods deal with inflation. As shown on the chart below, the illusory portion of total profit increased—that is, the difference between reported and economic profit widened—in 1973-1974 and again in 1978-1979, periods when inflation accelerated sharply. In 1975, a severe recession resulted in slower sales and a modest drop in reported profit. However, inflation subsided in the recession and, consequently, the illusory portion of reported profit shrank. The same thing has happened in the last year as the pace of the economy slowed and inflation abated.

The charts on the right side of back page show profit in relation to revenue from sales to end users; that is, revenue excluding transactions within the corporate sector. These data show substantial


Corporate Profit
Billions of Dollars
(Seasonally adjusted quarterly total at annual rate)
Ratio Scale
$250
200
100
90
80
70
60
50
40
30
20
10
Economic Profit Before Taxes
Reported book profit is based on conventional accounting of inventory cost and depreciation. Economic profit is based on replacement-cost accounting of inventory and depreciation, and on standardized straight-line depreciation. Inventory valuation and capital consumption adjustments (IVA and CCA) are the difference between the two profit measures. The sum of IVA and CCA is labeled Illusory Profit.
1960 '62 '64 '66 '68 '70 '72 '74 '76 '78 '80 '81

Change in Pretax Profit▲ Distribution





▲Excludes under-costing of inventory but not under-depreciation

short-term fluctuations due to the business cycle, but the declining trend in the pretax profit ratio is of more significance. As a partial offset to this trend, the effective tax rate on corporate profit had begun to decline long before the latest round of tax cutting.

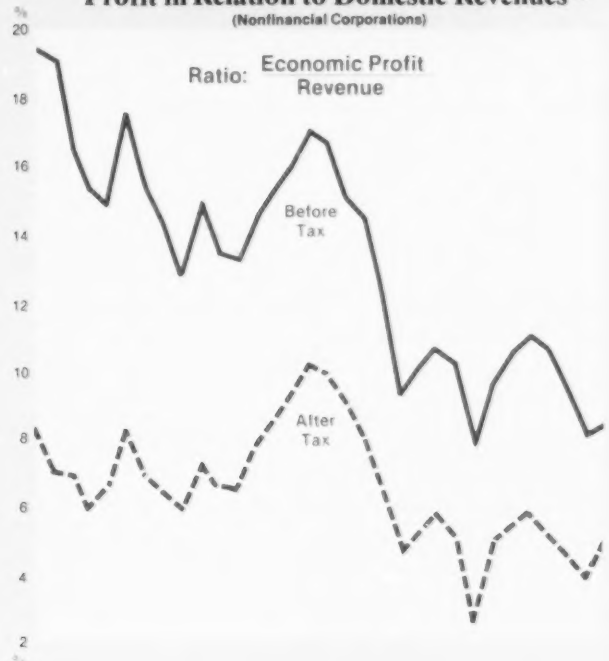
Declining profitability has resulted in reduced availability of internal funds for investment in modernization or expansion of facilities. Therefore, corporations have resorted increasingly to borrowing to finance investment. The lower chart shows the sum of economic profit after tax plus net interest payments as a ratio to revenue. This ratio is not affected by whether corporations, as a whole, choose debt or equity financing. It shows less cyclical fluctuation than the ratio of economic profit alone, and no long-term decline.

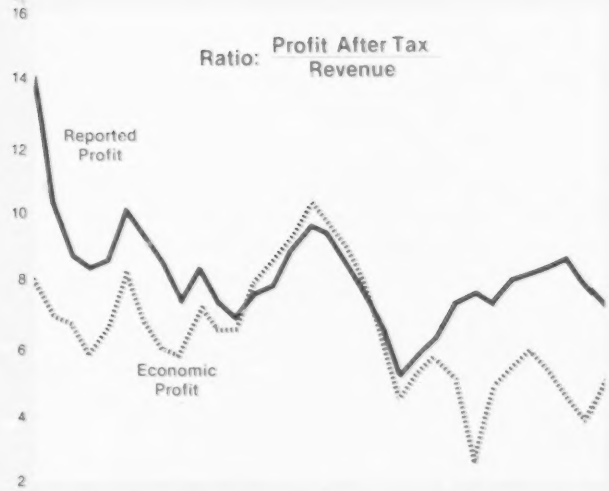
Ken Goldstein

Sources: Bureau of Economic Analysis; The Conference Board.

Profit in Relation to Domestic Revenues*

(Nonfinancial Corporations)





*Gross domestic corporate product (which excludes revenue from intracorporate transactions)

ECONOMIC ROAD MAPS

Eva Culen, Editor Chuck N. Tow, Lead Chartist

Prepared in The Business Conditions Analysis Department—Lora S. Collins, Director
Prices for Quantities of this chart will be supplied on request to Information Service.

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